

(4) *Remote and incidental contingencies.* For purposes of determining the amount of bond issuance premium and allocating bond issuance premium among accrual periods, if a bond provides for a contingency that is remote or incidental (within the meaning of § 1.1275-2(h)), the issuer takes the contingency into account under the rules for remote and incidental contingencies in § 1.1275-2(h).

(f) *Example.* The following example illustrates the rules of this section:

Example. (i) *Facts.* On February 1, 1999, X issues for \$110,000 a debt instrument maturing on February 1, 2006, with a stated principal amount of \$100,000, payable at maturity. The debt instrument provides for unconditional payments of interest of \$10,000, payable on February 1 of each year. X uses the calendar year as its taxable year, X uses the cash receipts and disbursements method of accounting, and X decides to use annual accrual periods ending on February 1 of each year. X's calculations assume a 30-day month and 360-day year.

(ii) *Amount of bond issuance premium.* The issue price of the debt instrument is \$110,000. Because the interest payments on the debt instrument are qualified stated interest, the stated redemption price at maturity of the debt instrument is \$100,000. Therefore, the amount of bond issuance premium is \$10,000 (\$110,000 - \$100,000).

(iii) *Bond issuance premium allocable to the first accrual period.* Based on the payment schedule and the issue price of the debt instrument, the yield of the debt instrument is 8.07 percent, compounded annually. (Although, for purposes of simplicity, the yield as stated is rounded to two decimal places, the computations do not reflect this rounding convention.) The bond issuance premium allocable to the accrual period ending on February 1, 2000, is the excess of the qualified stated interest allocable to the period (\$10,000) over the product of the adjusted issue price at the beginning of the period (\$110,000) and the yield (8.07 percent, compounded annually). Therefore, the bond issuance premium allocable to the accrual period is \$1,118.17 (\$10,000 - \$8,881.83).

(iv) *Premium used to offset interest.* Although X makes an interest payment of \$10,000 on February 1, 2000, X only deducts interest of \$8,881.83, the qualified stated interest allocable to the period (\$10,000) offset with the bond issuance premium allocable to the period (\$1,118.17).

(g) *Effective date.* This section applies to debt instruments issued on or after March 2, 1998.

(h) *Accounting method changes—(1) Consent to change.* An issuer required to change its method of accounting for bond issuance premium to comply with this section must secure the consent of the Commissioner in accordance with the requirements of § 1.446-1(e). Paragraph (h)(2) of this section provides the Commissioner's automatic consent for certain changes.

(2) *Automatic consent.* The Commissioner grants consent for an issuer to change its method of accounting for bond issuance premium on debt instruments issued on or after March 2, 1998. Because this change is made on a cut-off basis, no items of income or deduction are omitted or duplicated and, therefore, no adjustment under section 481 is allowed. The consent granted by this paragraph (h)(2) applies provided—

(i) The change is made to comply with this section;

(ii) The change is made for the first taxable year for which the issuer must account for a debt instrument under this section; and

(iii) The issuer attaches to its federal income tax return for the taxable year containing the change a statement that it has changed its method of accounting under this section.

[T.D. 8746, 62 FR 68176, Dec. 31, 1997, as amended by T.D. 8838, 64 FR 48547, Sept. 7, 1999]

§ 1.163(d)-1 Time and manner for making elections under the Omnibus Budget Reconciliation Act of 1993 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

(a) *Description.* Section 163(d)(4)(B)(iii), as added by section 13206(d) of the Omnibus Budget Reconciliation Act of 1993 (Pub. L. 103-66, 107 Stat. 467), allows an electing taxpayer to take all or a portion of certain net capital gain attributable to dispositions of property held for investment into account as investment income. Section 163(d)(4)(B), as amended by section 302(b) of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Pub. L. 108-27, 117 Stat. 762), allows an electing taxpayer to take all or a portion of qualified dividend income, as defined in section 1(h)(11)(B), into account as investment income. As a consequence,

the net capital gain and qualified dividend income taken into account as investment income under these elections are not eligible to be taxed at the capital gains rates. An election may be made for net capital gain recognized by noncorporate taxpayers during any taxable year beginning after December 31, 1992. An election may be made for qualified dividend income received by noncorporate taxpayers during any taxable year beginning after December 31, 2002, but before January 1, 2009.

(b) *Time and manner for making the elections.* The elections for net capital gain and qualified dividend income must be made on or before the due date (including extensions) of the income tax return for the taxable year in which the net capital gain is recognized or the qualified dividend income is received. The elections are to be made on Form 4952, "Investment Interest Expense Deduction," in accordance with the form and its instructions.

(c) *Revocability of elections.* The elections described in this section are revocable with the consent of the Commissioner.

(d) *Effective date.* The rules set forth in this section regarding the net capital gain election apply beginning December 12, 1996. The rules set forth in this section regarding the qualified dividend income election apply to any taxable year beginning after December 31, 2002, but before January 1, 2009.

[T.D. 9191, 70 FR 13100, Mar. 18, 2005]

§ 1.164-1 Deduction for taxes.

(a) *In general.* Only the following taxes shall be allowed as a deduction under this section for the taxable year within which paid or accrued, according to the method of accounting used in computing taxable income:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) State and local general sales taxes.

(5) State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels.

In addition, there shall be allowed as a deduction under this section State and local and foreign taxes not described in subparagraphs (1) through (5) of this paragraph which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income). For example, dealers or investors in securities and dealers or investors in real estate may deduct State stock transfer and real estate transfer taxes, respectively, under section 164, to the extent they are expenses incurred in carrying on a trade or business or an activity for the production of income. In general, taxes are deductible only by the person upon whom they are imposed. However, see § 1.164-5 in the case of certain taxes paid by the consumer. Also, in the case of a qualified State individual income tax (as defined in section 6362 and the regulations thereunder) which is determined by reference to a percentage of the Federal income tax (pursuant to section 6362 (c)), an accrual method taxpayer shall use the cash receipts and disbursements method to compute the amount of his deduction therefor. Thus, the deduction under section 164 is in the amount actually paid with respect to the qualified tax, rather than the amount accrued with respect thereto, during the taxable year even though the taxpayer uses the accrual method of accounting for other purposes. In addition, see paragraph (f)(1) of § 301.6361-1 of this chapter (Regulations on Procedure and Administration) with respect to rules relating to allocation and reallocation of amounts collected on account of the Federal income tax and qualified taxes.

(b) *Taxable years beginning before January 1, 1964.* For taxable years beginning before January 1, 1964, except as otherwise provided in §§ 1.164-2 through 1.164-8, inclusive, taxes imposed by the United States, any State, territory, possession of the United States, or a political subdivision of any of the foregoing, or by any foreign country, are deductible from gross income for the taxable year in which paid or accrued, according to the method of accounting used in computing taxable income. For this purpose, postage is not a tax and